

Bosnia and Herzegovina

Natural disaster has interrupted economic recovery

General Information



GDP	USD17.05 billion (World ranking 111, World Bank 2012)
Population	3.83 million (World ranking 128, World Bank 2012)
Form of state	Emerging Federal Democratic Republic
Head of government	Vjekoslav BEVANDA (Chairman of the Council of Ministers)
Next elections	2014, presidential and legislative



Strengths

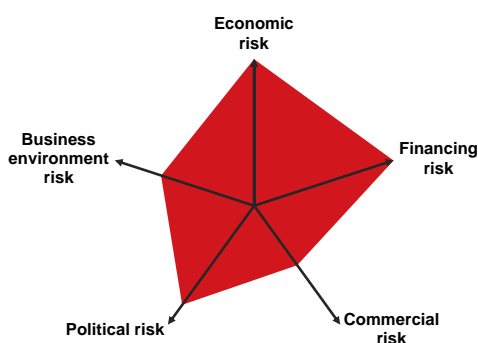
- A currency board has helped to provide a stable exchange rate and fairly low inflation
- Foreign exchange reserves currently cover more than 5 months of imports

Weaknesses

- Persisting ethnic-nationalistic pressures. Highly ethnically fragmented government hinders efficient policymaking
- Widespread poverty and high unemployment
- Small manufacturing base concentrated on low-value-added products
- Main export destinations are other emerging Eastern European countries
- Unsustainably large current account deficits.
- High external debt burden
- High vulnerability to external shocks, including natural disasters

Country Rating

D4



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Croatia	15% 1	16% Croatia
Serbia and Montenegro	13% 2	12% Serbia and Montenegro
Germany	11% 3	10% Germany
Italy	11% 4	10% Russia
Slovenia	11% 5	8% Slovenia

By product (% of total)

Exports	Rank	Imports
Leather	8% 1	8% Crude Oil
Non Ferrous Metals	7% 2	7% Refined Petroleum Products
Iron Steel	5% 3	4% Plastic Articles
Refined Petroleum Products	5% 4	4% Leather
Miscellaneous Hardware	5% 5	4% Miscellaneous Hardware

Source: Chelem (2012)

Economic Overview

Severe floodings and landslides disrupt recovery

Following relatively robust average annual real GDP growth of +4.8% in 2000-08, the economy of Bosnia and Herzegovina (BiH) experienced a double-dip recession in 2009 (-2.7%) and 2012 (-1.2%) in the wake of the global financial crisis. In 2013, the economy recovered modestly, growing by +2.1%, although domestic demand remained weak.

In 2014, GDP growth is forecast to slow to about +0.7% as torrential rains in May caused substantial damage, affecting almost 25% of the population and estimated at 5-10% of GDP. In the absence of further natural disasters, growth should recover to around +2.2% in 2015.

Unemployment will remain high at about 25%, especially among the youth.

Currency board limits exchange rate and inflation risk but cannot prevent deflation

A currency board exchange-rate regime — which pegs the convertible marka (BAM), the local currency, at 1.96 to the EUR — has been in place since 1995 and is probably among the strongest institutions in BiH. It has generally served well to keep annual average inflation in check, even though fluctuating prices of oil and food — the latter comprises about 55% of household purchases — have tended to cause some volatility. There is currently no evidence of a significant real exchange rate misalignment and the central bank's current official reserves are sufficient to cover the whole monetary base (which is a requirement for a currency board), such that we expect the currency board to remain in place in 2014-2015.

Inflation has been moderate in recent years and has been in deflationary territory in August 2013, standing at -0.9% y/y in July 2014. EH expects positive inflation to return in H2, reaching about +0.5% at end-2014 and +1.5% at end-2015.

Fiscal consolidation jeopardised by natural disaster

The fiscal deficit has gradually narrowed from 5.8% of GDP in 2009 to 2.2% in 2012. However, it is forecast to rise to above 4% of GDP in 2014 as the fiscal consolidation path will be interrupted as a result of the huge shock to the economy caused by the natural disaster. Fiscal revenues will fall markedly in 2014 while spending needs will rise. The fiscal deficit is then forecast to narrow to 3.5% of GDP in 2015.

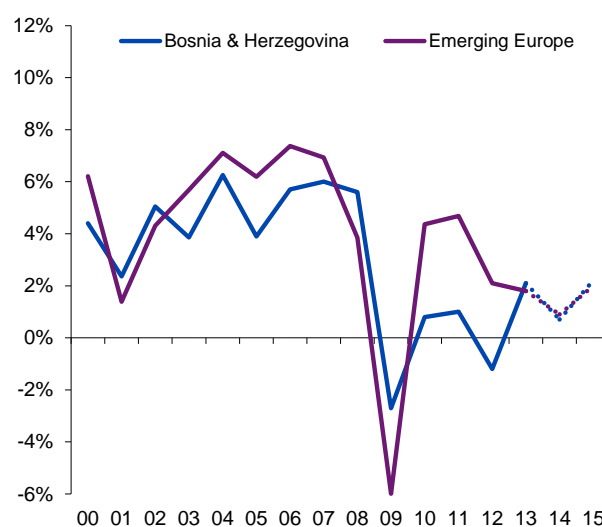
Public debt more than doubled from 19% of GDP in 2007 to about 45% in 2012, before falling slightly to 43% in 2013. In 2014-15, the ratio will rise modestly as a result of the interrupted fiscal consolidation.

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	-1.2	2.1	0.7	2.2
Inflation (% end-year)	1.8	-1.4	0.5	1.5
Fiscal balance (% of GDP)	-3.1	-2.2	-4.1	-3.5
Public debt (% of GDP)	44.6	42.7	46.2	47.0
Current account (% of GDP)	-9.7	-5.6	-10.7	-9.0
External debt (% of GDP)	52.2	50.8	54.6	56.0

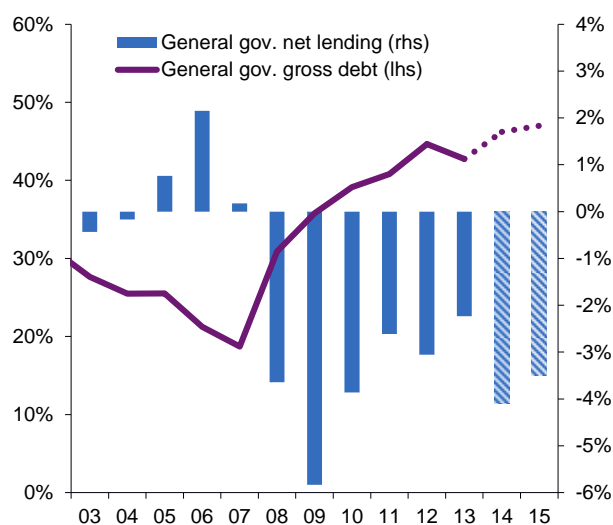
Sources: National sources, IMF, IHS, Euler Hermes

GDP growth (%)



Sources: IMF, IHS, Euler Hermes

Public finances (% of GDP)



Sources: IMF, Euler Hermes

Overall external liquidity risk remains high ...

Bosnia and Herzegovina's external position remains weak. Despite debt reduction agreements with the Paris and London Clubs and substantial international aid, post-war economic progress has been attained at the expense of sizeable and worrisome external imbalances. The country has persistently run substantial current account deficits. The deficit was close to 10% of GDP in 2011-2012, though it narrowed to 5.6% in 2013. The natural disaster in May 2014 will also have an adverse effect on the current account deficit which is forecast to widen again to around 11% of GDP in 2014, before slightly narrowing to 9% in 2015.

Net FDI inflows have covered just 31% of the cumulative current account deficit in 2008-2013, requiring the remaining financing gap to be met through new external indebtedness. Hence, gross external debt has remained relatively high at around 50% of GDP or 190% of export earnings and is forecast to rise further in the near future.

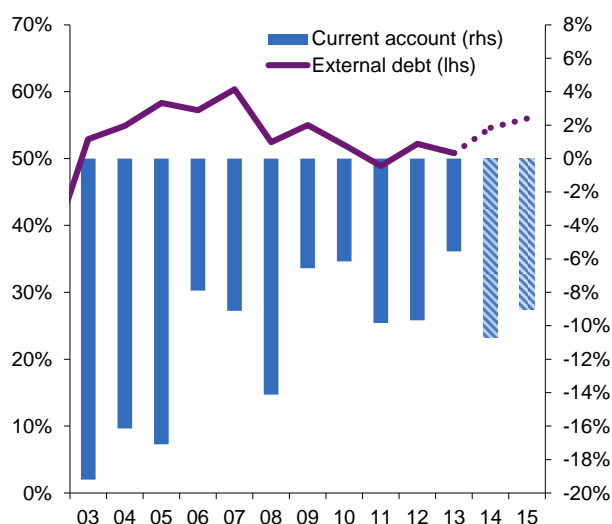
On a positive note, foreign exchange reserves stood at USD4.8bn in May 2014, sufficient to cover more than five months of imports.

... and BiH remains dependent on foreign assistance

A high vulnerability to external shocks was revealed by the 2008-09 global economic crisis which pushed the economy into recession and crisis. An IMF financial support package was needed and approved in mid-2009 (a total of EUR1.1 billion). A subsequent two-year IMF facility was granted in September 2012 and extended for nine months in early 2014 (through end-June 2015) as well as augmented two times (reaching a total of around EUR632 million). The second augmentation was requested by the Bosnian authorities and granted by the Fund in mid-2014 to address the urgent balance of payments need caused by the natural disaster in May 2014, which once again reflected the country's vulnerability to external shocks. Other international financial institutions are also likely to provide assistance for the recovery and reconstruction.

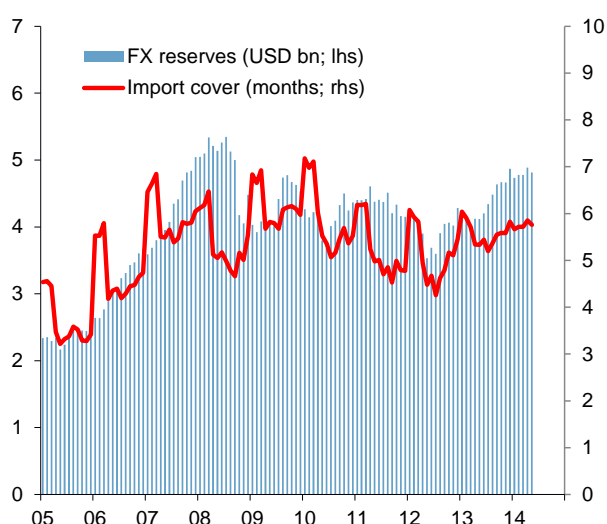
Overall, Bosnia and Herzegovina will remain highly dependent on international transfers in the foreseeable future and is still far from attaining self-sustaining growth. External liquidity and debt risks will remain very high in the medium term.

Current account and external debt (% of GDP)



Sources: IMF, IHS, Euler Hermes

Foreign exchange reserves and import cover



Sources: IMF, IHS, Euler Hermes

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